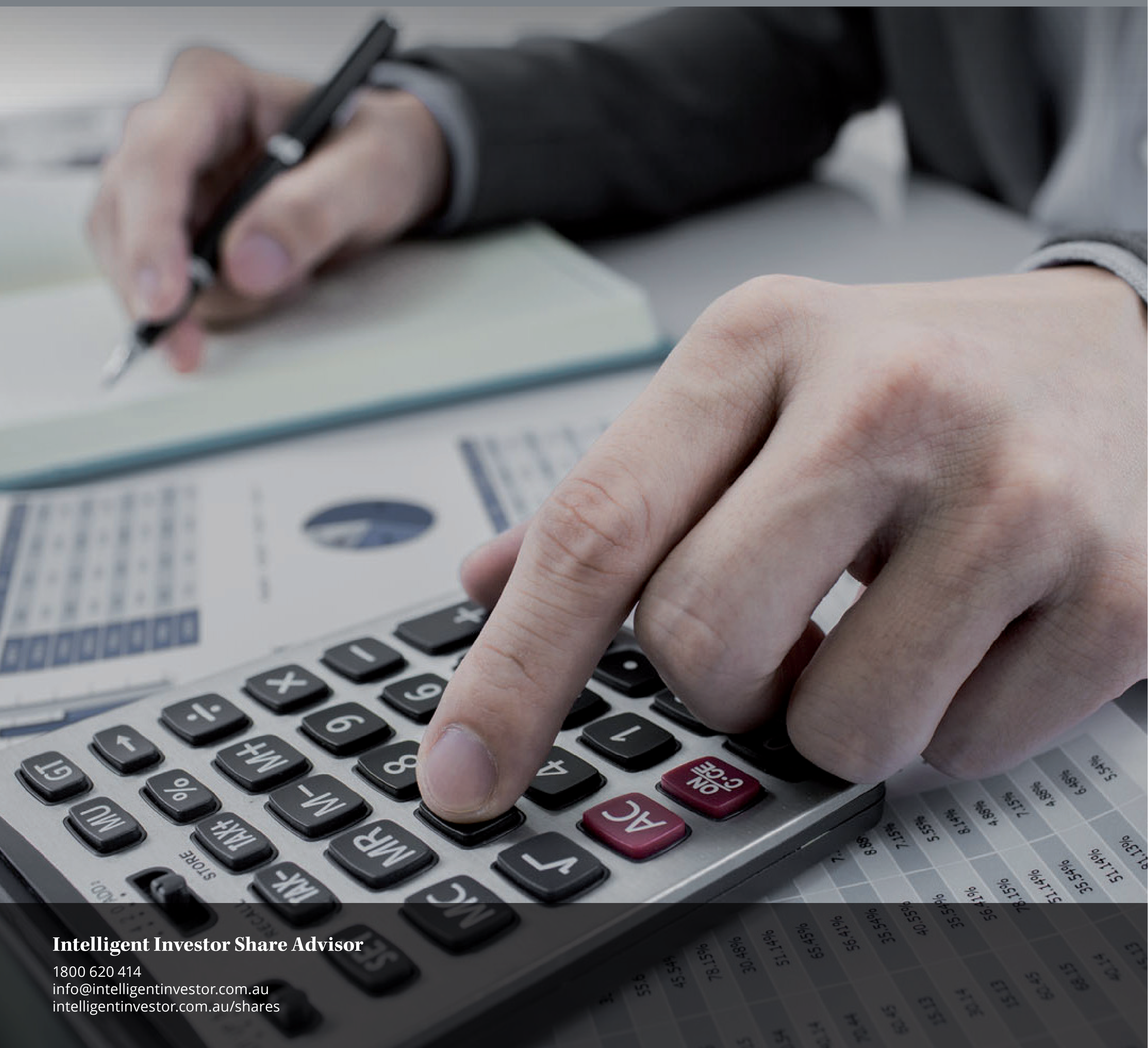
INTELLIGENT INVESTOR
SHARE ADVISOR

Top Stock Picks

From Australia's best fund managers

■ EFY 2015 Special Report



Intelligent Investor Share Advisor

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Contents

Stock Articles

Note: The fund managers in this report and their funds own many of the stocks mentioned.

A letter from the Editor

Dear Intelligent Investor,

This is the third year we've rounded up what we consider to be some of the country's best value-oriented fund managers and asked them to nominate a few stocks. In my (incredibly biased) view, this is the biggest and best report yet.

This year, there were no limitations on what the managers could pick. Many international stocks are featured, from Chinese insurers and NASDAQ-listed subprime lenders to Spanish mining services companies and South Korean banks.

Members that only invest in ASX-listed stocks won't be disappointed, either. There are a dozen local stock ideas for you to investigate and enjoy, including one or two companies that may surprise you. There really is something here for everybody, from deep value local picks to international companies with strong brands and attractive valuations.

Needless to say, none of the stocks referred to constitute an endorsement or recommendation from Intelligent Investor. These are stock ideas from people we respect, to be investigated under your own steam and at your own pace.

Please also bear in mind that whilst these fund managers were asked to pick stocks they'd be happy to purchase at prices around the end of May 2015, they may well have established positions before then, potentially at entry prices quite different from the prices at which they now trade. So, caveat emptor and all that.

One of the themes emerging from this basket of stocks is their international flavour. Even many of the local selections like **Surfstitch** and **GBST** generate large licks of overseas revenue. This reflects the relative valuations available in Australian stocks right now compared with other areas of the world. As members well know, we've been banging this drum for years and over the past six months many others are now singing the same tune. Allocating at least some of your portfolio to overseas markets has gone mainstream.

If you haven't already acted, is it too late? Many international markets aren't as cheap as they once were but plenty of opportunities still exist. Moreover, the sheer volume of stocks listed beyond Australia's shores increases the pool of opportunity. For those that haven't yet invested overseas this report offers much to ponder.

Lastly, I'd like to thank the fund managers for their contributions. Australian investors are lucky to have such a talented bunch of managers. For those investors that don't want to manage their own money or are happy to allocate some of their portfolio to the professionals, you can still get great performance without it costing you the earth.

I trust you enjoy their stock picks.

Yours sincerely,

John Addis,
Founder and editor,
Intelligent Investor Share Advisor

Antipodes Global Investment Partners

Jacob Mitchell

Believing that opportunities arise only when disguised as something else, Jacob Mitchell offers three favourably priced international stocks that are not quite as they seem.

Despite recent rises, the structural shift now underway is not yet captured in the company's share price.

Collapsing energy prices, persistent low growth and policy-induced currency debasements; what is an investor to do in the face of such threats?

Profile

BACKGROUND

Jacob Mitchell was formerly Deputy Chief Investment Officer at Platinum Asset Management and a Portfolio Manager of the flagship Platinum International Fund. Partnering with Pinnacle Investment Management, he launched Antipodes Global Investment Partners earlier this year.

PERFORMANCE

As Portfolio Manager for the Platinum Unhedged Fund between Jan 2007 and May 2014, Jacob achieved 6% per annum outperformance after fees. Between January 2008 and November 2014 as Portfolio Manager of the Platinum Japan Fund, he delivered 10% per annum outperformance after fees.

MORE INFORMATION

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Nippon Electric Glass

Because opportunities naturally arise disguised as something else, the answer is to look beyond the obvious. In the case of my first pick – **Nippon Electric Glass** (5214-JP) – the company's poor operating history is mistakenly embedded as a permanent feature in its valuation. This has been a poorly performing business but the LCD glass industry is now an oligopoly featuring significant barriers to entry, bringing with it the opportunity to transform Nippon's economics and shareholders' returns. I believe the market is missing this point.

The LCD glass industry is dominated by three players; **Corning** (NYSE:GLW) with a 50% share, **Asahi Glass** (5201–JP) with 25% and **Nippon Electric Glass** (NEG) with 20%. Smaller players like LG Chemical, **Saint Gobain** (ENXTPA:SGO) and Schott have struggled to keep pace with falling prices and rising technical hurdles. This, plus two other factors, is good news for the bigger players.

Not only has the market become less competitive but Corning's decision to offer customers guaranteed best prices in return for guaranteed fixed supply removes the incentive for Asahi and NEG to discount to win market share. Indeed, Asahi and NEG now have scope to raise prices knowing that Corning will not undercut them. Less price competition should result.

The third and final factor also raises the prospects of better financial returns for the Japanese glass companies. Whilst the LCD glass industry is denominated in Japanese Yen, the final products in which the glass is incorporated (TVs, notebook PCs, etc) are largely priced in US dollars. During the period of the Yen's strength up until 2013, Japanese suppliers were at a competitive disadvantage. Coupled with rising energy costs after the Fukushima nuclear power plant shut down, NEG suffered a bleak winter. The company is now emerging from this difficult period, assisted by the policy-induced weakness in the Japanese Yen.

With China Inc. now embarking on the next wave of panel production, LCD glass manufacturers are set to benefit from rising demand, higher prices and reduced competition.

So, how much are investors paying for this undiscovered opportunity? Trading at just 0.6 times book value with net cash on its balance sheet, NEG carries the type of asymmetric risk-reward profile we like. The company's recent surprise revision to its margin outlook is evidence of the changing industry dynamics. Despite recent rises, the structural shift now underway is not yet captured in the company's share price.

"The company's brand, breadth of solutions and incumbency will make it a difficult competitor to dislodge.

That explains why NEG is one of the larger positions in our funds. As investors become more comfortable with the idea of sustainably higher industry returns, as has occurred in the DRAM and Hard Disk Drive industries, valuations can and should expand. A mid-cycle earnings valuation of 1.5x book value is well within reach.

Cisco

Once considered one of the four horsemen of the internet, **Cisco**'s (NASDAQ:CSCO) lowly rating suggests the company's best days are behind it. The opportunity is in Cisco capturing significant market share as the transition to software defined networking gets underway.

Let's look at the bear case first. Cisco supplies networking hardware with a software layer that enables network functions like bandwidth provision, security features and user entitlements. The bears believe that software defined networking (SDN) will remove the intelligence from the hardware, collapsing hardware pricing. Meanwhile, OpenFlow software standards will allow multiple software vendors to compete for the profit pool that is now dominated by Cisco.

The bull case revolves around Cisco's response to this competitive threat. The company has quickly secured a strong position with its own SDN software stack. Our recent discussions with marquee Cisco customer **Telstra** (ASX:TLS) suggest that the company's brand, breadth of solutions and incumbency will make it a difficult competitor to dislodge. Whilst there may be some hardware pricing pressure, SDN adoption has the potential to increase demand for switching equipment as the burden of greater functionality puts pressure on antiquated networking installations. The era of big data only adds to this pressure.

We believe Cisco is set to enter the next phase in its evolution, making the company's lowly PER of 11 (net of cash) seem unjustly cautious. In recent years the company has accelerated its buyback program, introduced a dividend and successfully cut costs in a low growth environment. Shareholders are now set to benefit as a new era of software defined networking emerges. With the Nexus 9K+3K – part of Cisco's SDN solution – growing 144% year on year in the most recent quarter, one of the original horseman of the Internet may yet ride again.

KB Financial Group

Our third and final pick is South Korean banking leader **KB Financial Group** (105560-KS), an interesting case study of relative valuations for Australian bank investors. KB is the domestic retail bank market leader in the relatively mature Korean economy, one with high but manageable household debt matched by conservative net government and corporate debt levels.

Since the Asian crisis of the late 1990s, South Korea's banking market has consolidated. Four major private sector players compete in the retail market against disinterested international banks and poorly run government institutions. KB is the leading digital bank in the country with its app downloaded more than any other.

There are three reasons we hold KB shares, the first concerning our favourable view of the Korean economy. GDP growth is averaging a reasonable 3%, inflation is benign and construction activity, which has been falling since 2008, is finally picking up.

With the Korean Government running budget surpluses and the country's world class, export-led tech companies (**Samsung** (5930–KS)) and car makers (**Hyundai** (5380–KS)) doing their bit, Korea's current account surplus is over 6% of GDP.

Bank lending to households is now running at double-digit growth, a rate that can be maintained with lower interest rates. Together with the Government's desire to increase domestic spending, Korea is an environment conducive to rising home prices, with KB a clear beneficiary.

The second issue is company-specific. KB is undergoing a significant restructure. New management, focused on improving efficiency, is offering redundancy packages to about 25% of its workforce. Should half accept, we think this would increase NPAT by around 10%. As KB gains market share as a result of its digital initiatives, there may be further cost savings.

The final reason is valuation. At 0.6x tangible book value and a 2015 PER of 9 (8 if we factor in the restructuring), today's buyers don't need a consolidating market that should increase margins, a strong economy, double-digit household lending growth, rising house prices or a successful restructure to do well.

We doubt everything will work out perfectly but, in a country where the 'smart money' is averse to borrowing for a house for fear of losing on the investment, KB offers a reassuring margin of safety with plenty of potential for share price growth at current prices.